

The risk/reward trade-off is key to choosing investments that are right for you, because most people have different ideas about how much risk they should take with their money. Some are conservative and want to keep it someplace safe, like a savings account. Others are more aggressive and are willing to invest it someplace riskier, like the stock market. In the end, you have to decide how comfortable you would be with an investment that could frequently go up and down in price.

Of course, the reward for taking on risk is your return on investment. Return can be made up of income such as interest or **dividends** (which are a share of the profits you receive as a stockholder). Return can also come about from growth stock prices, called **capital gains**. If an investor buys a stock and sells it later at a higher price, the difference between the purchase price and the selling price is called a **capital gain**. So if you bought Stock Z for \$10 per share in 2000, then sold it for \$25 per share in 2005, your profit, or capital gain, is \$15 per share. If an investor ends up selling a stock at a lower price, the difference is called a **capital loss**.

When talking about return, people usually cite an investment’s **rate of return** or rate of interest, which is simply the annual percentage return on an investment. In short, it tells you how fast your money is growing.



**Exercise 3D: Risk versus Reward**

Two people have different investment strategies. Read about their situations and then follow directions to compare their investment portfolios.

**Carrie Montgomery**, age 27 and single, has an emergency fund in an insured savings account. Her other investments include a balanced mutual fund, a growth mutual fund, and collectibles in the form of baseball cards. Sixty percent of the money in these investments is in a growth mutual fund, and 20 percent of the money is in each of the other two investments.

**Darren Miller** is 22 and also single. He has an adequate emergency fund in U.S. savings bonds. The remainder of his investment program includes equal amounts of money invested in a money market mutual fund, high-grade preferred stock, and blue-chip common stock.

Elements to Compare	Carrie	Darren
Who has a lower-risk investment program?		
Who has the potential for higher earnings?		
What is each person’s highest-risk investment?		
What is each person’s lowest-risk investment?		

**An Array of Investment Options**

There are many ways to put your money to work for you. We’re going to talk about an array of different investment options, all of which work better in certain situations than others.

Generally, people choose to invest for one of two reasons: *income* or *growth*. Income means they get paid—in cash—for owning the account or investment. Growth means they buy and hold an investment with the hope that it will increase in price, over time.